State of Rhode Island and Providence Plantations

STATE INVESTMENT COMMISSION

Regular Meeting January 23, 2008

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, January 23, 2008. The Treasurer called the meeting to order at 9:00 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Mr. William Bensur, of Wilshire Associates Incorporated, General Consultant to the Commission; Ms. Lisa Tyrrell of the State Street Corporation; Mr. Frank Karpinski, Executive Director of RIERS; and other members of the Treasurer’s staff. Ms. Reback excused herself at 10:15 a.m.

State Investment Commission Minutes. The Treasurer entertained a motion for approval of the minutes. Dr. Mc Kenna moved, Ms. Reback and Mr. Treat seconded and the motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

VOTED: To approve the Minutes of the December 6, 2007 regular meeting.

Wilshire Associates Incorporated – Capital Markets Review. Prior to the Capital Market Review, Treasurer Caprio stated that due to the current volatility of the market the Staff has been monitoring the Private Equity portion of the portfolio. This asset allocation is particularly sensitive to the extreme highs and lows in the market; as a result, capital calls have increased. Treasurer Caprio suggested that the Commission delay making any decisions regarding additional Private Equity investments until we see a re-balancing of the portfolio.

Mr. Bensur began by stating that there will be slower growth in 2008. He expects inflation to be in the range of 2% - 2.5 %; economic growth will flatten out in 2008. The credit and liquidity crisis caused by the sub-prime market has spilled over to the equity markets. Mr. Bensur believes the volatility within the global equity markets will continue during the first half of 2008 and then will level off during the second half. This is a global phenomenon affecting the Asian, European, and Emerging markets, as well as the U.S. market.

Mr. Bensur referred to 2007 returns: the U.S. Equity segment of the market was up about 5.5% attributed mainly to large cap stocks; small cap stocks were down about 1.5 % measured by the Russell

2000; mid cap stocks in general had positive returns; the Dow Jones Wilshire 5000 was up about 5.6% for the year; Non U.S. Equity in developed markets was up about 11.5%; emerging markets were up approximately 39.8%; the bond market was up approximately 7%; high yield was up about 2%.

Mr. Bensur gave the following report regarding market conditions at the close of business on January 22, 2008: the S&P 500 was down 10.7%; small cap was down about 12%; developed markets were down about 12%; emerging markets were down 13.5%; bonds continue to do well; the Lehman Aggregate is up about 2.3%; high yield was down about 2%.

Treasurer Caprio asked for a review of the Benchmark and Allocation Study. Mr. Bensur began by explaining the resources and tools used by his research teams each year to forecast capital markets performance. Wilshire's asset class return, risk, and correlation assumptions are developed based on a ten year expected rate of return. The study is adjusted to incorporate recent trends. He went on to discuss the variables used to arrive at a forecast of returns for each asset class. The report Mr. Bensur distributed to the Commission is not fully vetted. However, a complete report will be distributed by Wilshire Associates in a week.

The projections from 2007 to 2008 changed only in the following asset allocations: Non-U.S. Equity +0.25%; Fixed Income -0.25%; TIPS -1.00%; Private Markets -0.50%. Mr. Bensur went on to discuss the

details of four different models

of alternative policy portfolios, stating what the potential risks and returns may be for each. The model policy portfolio returns would range from 7.65% to 8.10%. The current policy has an expected rate of return of 7.92%. In the existing capital market environment, RIERS will face challenges trying to achieve the discount rate/return of 8.25%. Mr. Bensur recommends maintaining a long term approach while continuing to explore ideas that may increase expected return, decrease expected risk, or both.

Treasurer Caprio noted when the fiscal year ended on June 30, 2007 the portfolio had exceeded its target of 8.25%. However, the Auditor General's Report indicated that we lagged against our benchmark by close to 300 basis points. If the Commission had benchmarked all asset allocation percentages without the participation of our active managers, the portfolio would have captured the additional 300 basis points. The shortfall was due to under performance in the international area. All three International Managers are culpable, but the loss was more attributable to The Boston Company. International Management fees are generally more costly than other management fees.

Treasurer Caprio noted the importance of exposure to the international markets, adding that the issue now is how the exposure will be managed and what type of resources the Commission is going to devote to this portion of the portfolio. Mr. Bensur stated that he

felt the active managers have had a difficult time keeping pace with the sizable beta returns within the international markets. From a return standpoint, the allocation is attractive but the implementation tools did not perform within expectations. Passive management or indexing has been growing as an institutional implementation tool within the Non U.S. Equity space, which would save the Commission active management fees.

Mr. Goodreau asked whether ERSRI is more concerned with benchmark risks or total return risks. ERSRI's portfolio requires a different investment style. Remaining in capital markets for an extended period of time patiently waiting ten to fifteen years to achieve targeted returns does not work due to our short term and intermediate term liabilities. Therefore, there may be periods of time when our managers occasionally have to take a tactical position and ratchet down risk and exposure. Risk should be addressed on a monthly, quarterly, and semi-annual basis to allow flexibility and shifting of asset classes, as needed. When markets are turbulent we do not have the flexibility to shift asset classes at this time because there are no offsetting non-correlating asset classes in place. If the Commission decides to index the portfolio, ERSRI will have exposure, create efficiencies, reduce costs, and reduce risk. The other option would be to put decisions regarding investment options in the hands of active managers, providing they are truly active alpha managers.

Treasurer Caprio remarked that the portfolio had a 20% unfunded

liability which has increased during the last five years to 45%; primarily because the average return during this period was 2.5% rather than the projected 8.25%. He asked the Commission to consider whether we should stay the course and possibly earn returns once again of 2.5% over the next five years, or consider prudent changes in management and management styles that will benefit the taxpayers and retirees. He noted that the RFP consultant process is underway which should have a positive affect on ERSRI's portfolio.

Mr. Treat asked how often the current asset allocations are reviewed. Mr. Bensur replied the review is done on an annual basis, but they are forecasted out ten years. A conversation ensued with Mr. Bensur, Treasurer Caprio, Mr. Goodreau and Commission Members regarding asset allocation management tools and styles in regard to how they are affected by specific market conditions. Treasurer Caprio thanked everyone for their comments and concluded by stating that the Staff and Commission's goal is to be very proactive and innovative toward achieving the goal of highest rate of return with a minimal element of risk.

Manager Continuation Policy Analysis & Review – The Boston Company. Mr. Bensur stated that The Boston Company is down 10% for the year relative to market opportunity. In August or September 2007, The Boston Company came before the Commission. At that time, the Staff and Commission decided to watch their performance

for the next six months before making any decisions. Mr. Bensur recommended no action be taken at this time, as during these challenging and volatile times in the equity market this product is expected to do well. When there is enough significant cyclical recovery, this will be the appropriate time to make a recommendation to terminate or maintain the relationship with The Boston Company. An index exposure would provide an appropriate short term alternative. This will accomplish two things: anchor this portion of the portfolio to the Non–U.S. Equity market and reduce fees. Mr. Bensur suggested watching the fund into the second quarter of 2008.

Alternative Investments Consultant – PCG. Treasurer Caprio stated that Ms. Davidson will be giving a review of 2007 allocation performance to Mr. Goodreau and will report to the Commission at a later date. The Treasurer remarked that all numbers are very strong and as of December 31, 2007, we were fully allocated in the Private Equity portion of the portfolio, so there is no urgency to add new investments.

Legal Counsel RFP Recommendations. Treasurer Caprio explained the need to obtain RFP's for all service providers within the Treasury Department when contracts are expiring. This is prudent in regard to cost efficiency and superior service. As such, when the legal contract was near expiration an RFP was issued. He remarked that Brown Rudnick Berlack Israels has done a great job, but their fee

structure is more in line with New York legal fees; they admittedly do not have the flexibility to bring their fees within our expectations. The relationship with Brown Rudnick Berlack Israels will continue to be positive and they have agreed to assist the Commission in the future, if needed.

Mr. Mark Dingley, Legal Counsel/Chief of Staff, announced that a sub-committee of the Commission made the following recommendations: Adler Pollack & Sheehan will handle all investment transactions and Rodio & Ursillo will handle all administrative services. These changes will continue to provide the Commission with superior service while reducing costs. The Treasurer added that with Mr. Dingley's past experience as General Legal Counsel to a publicly traded company, a fair amount of legal work can be done in house resulting in additional savings. The Treasurer entertained a motion for approval of the recommendations of the Legal Sub-Committee as stated on the Legal RFP Summary. Mr. Treat so moved, Mr. Reilly and Ms. Gallogly seconded. The motion was passed and the following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Mr. Reilly, Mr. Treat, and Treasurer Caprio. Ms. Reback was absent.

VOTED: To approve the recommendations from the Legal Sub-Committee for change in Legal Counsel as stated on the Legal RFP Summary.

Deputy Treasurer for Finance Report. Mr. Goodreau stated we are in a credit crunch which is affecting the amount of money our Private Equity Firms are requesting. Capital calls are becoming more aggressive while business is slowing down, so we are not recouping the capital contributions. For the short term, we will start looking into new Private Equity opportunities once the markets have made a correction. Mr. Costello and Mr. Reilly both remarked that Private Equity is a lucrative investment and should not be tabled for a lengthy period. Mr. Gaudreau replied that is not his intention. He will be meeting with Ms. Davidson of PCG to discuss our Private Equity allocations and will report back to the Commission.

Treasurer's Report. The Treasurer commended the Commission and Staff for deciding to add Wellington Management Company to our team of managers. He stated this is an example of superior performance (alpha) by an active manager in a fund of a manageable size. This is the type of manager, within Domestic Equity, that the Commission will be looking for in the future.

Treasurer Caprio noted that we have received all RFP's from the companies interested in the Consultant position. A sub-committee is being formed and the Treasurer encouraged all Members and Staff to join the committee to participate in the selection process. Mr. Gaudreau and Mr. Reilly have already expressed an interest to serve on the sub-committee. The Treasurer hopes to have some recommendations for the February SIC Meeting.

New Business. **There being no questions and no new business, Treasurer Caprio entertained a motion to adjourn the meeting. Mr. Costello moved, Ms. Gallogly seconded and the motion was passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Mr. Reilly, Mr. Treat, and Treasurer Caprio. Ms. Reback was absent.**

VOTED: To adjourn the meeting

There being no further business, the meeting was adjourned at 11:00 a.m.

Respectfully submitted,

Frank T. Caprio
General Treasurer